

LIBRARY
SUPREME COURT, U. S.

Office - Supreme Court, U. S.

FEB 23 1949

JAN 7 1949

CHARLES E. CLARK

IN THE
Supreme Court of the United States

October Term, 1948.

Nos. 226, 227, 243.

SECURITIES AND EXCHANGE COMMISSION, THOMAS
W. STREETER, et al., THE HOME INSURANCE
COMPANY, et al.,

Petitioners,

v.

CENTRAL-ILLINOIS SECURITIES CORPORATION,
C. A. JOHNSON, LUCILLE WHITE, and
FRANCIS BOEHM,

Respondents.

No. 266.

CENTRAL-ILLINOIS SECURITIES CORPORATION,
and CHRISTIAN A. JOHNSON,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION, THOMAS
W. STREETER, et al., THE HOME INSURANCE
COMPANY, et al.,

Respondents.

On Writs of Certiorari to the United States Court of Appeals
for the Third Circuit.

**ANSWERING BRIEF FOR THE HOME INSURANCE
COMPANY AND TRADESMENS NATIONAL
BANK AND TRUST COMPANY AS
RESPONDENTS IN NO. 266.**

FRANCIS H. SCHEETZ,

*Attorney for The Home Insurance
Company, et al., Petitioners-
Respondents,*

1335 Land Title Building,
Philadelphia 10, Pa.

INDEX.

	Page
Opinions Below	2
Jurisdictional Statement	2
Statutes Involved	2
Analysis of Issues and Supplementary Statement ...	2
Summary Analysis of Central-Illinois' Contentions	3
Supplementary Statement	6
(1) Statements Regarding the Charter Involuntary Liquidation Preference and the Frustration Doctrine	6
(2) The Commission's Valuations	8
(3) The Alleged Advance Approval by the Commission of the Plan as Modified by the District Court	11
Argument	14
I. The Contention That the Charter Involuntary Liquidation Preference and the Frustration Doctrine Preclude Payment of More Than \$100 Per Share	14
II. The Contention That the Preferred Stocks Could Not Be Valued at More Than \$100 Per Share	18
III. The Contention That the District Court May Exercise Its Independent Discretion and Is Not Bound by Findings of the Commission Based on Substantial Evidence and Having Rational Foundation in Law ...	20

CASES.

	Page
Bailey v. Minsch, 168 F. 2d 635 (C. A. 1, 1948) (reversing 76 F. Supp. 614) cert. den. 69 Sup. Ct. 83..	14, 15
Engineers Public Service Co., In re, 71 F. Supp. 797 (D. Del. 1947)	2
Engineers Public Service Co., In re, 168 F. 2d 722 (C. A. 3, 1948)	2
Knight v. Wertheim & Co., 158 F. 2d 838 (C. A. 2, 1946) cert. den. sub. nom. McGuire v. Equitable Office Bldg. Corp., 331 U. S. 818	15
Matton Oil Transfer Corp. v. The Dynamic, et al., 123 F. 2d 999 (C. A. 2, 1941)	20
Otis & Co. v. S. E. C., 323 U. S. 624	3, 7, 14, 17
United States v. Forness, 125 F. 2d 928 (C. A. 2, 1942)	20
Western Public Service Company, 12 S. E. C. 804 (1943)	8

STATUTES.

	Page
Bankruptcy Act, Section 77 (e), 11 U. S. C. 205 (e) (See Main Brief Appendix pp. 50-54)	2
Judicial Code, Section 240, 43 Stat. 938; 28 U. S. C. 347	2
Public Utility Holding Company Act of 1935, 15 U. S. C. 79 et seq. (See Main Brief Appendix pp. 45-49) :	
Section 11 (b)	3, 12
Section 11 (d)	2, 12
Section 11 (e)	2, 12, 21
Section 11 (f)	2
Section 18 (f)	2
Section 24 (a)	2
Section 25	2

IN THE
Supreme Court of the United States.

October Term, 1948.

Nos. 226, 227, 243.

SECURITIES AND EXCHANGE COMMISSION, THOMAS
W. STREETER, et al., THE HOME INSURANCE
COMPANY, et al.,

Petitioners,

v.

CENTRAL-ILLINOIS SECURITIES CORPORATION,
C. A. JOHNSON, LUCILLE WHITE, and
FRANCIS BOEHM,

Respondents.

No. 266.

CENTRAL-ILLINOIS SECURITIES CORPORATION,
and CHRISTIAN A. JOHNSON,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION, THOMAS
W. STREETER, et al., THE HOME INSURANCE
COMPANY, et al.,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE THIRD CIRCUIT.

ANSWERING BRIEF FOR THE HOME INSURANCE
COMPANY AND TRADESMEN'S NATIONAL BANK
AND TRUST COMPANY AS RESPONDENTS IN NO.
266.

OPINIONS BELOW.

The opinion and judgment of the Court of Appeals
for the Third Circuit (R. 12), and the opinion denying

petitions and cross-petitions for rehearing (R. 138) are reported at 168 F. 2d 722 (C. A. 3, 1948). The opinion of the District Court is reported at 71 F. Supp. 797 (D. C. Del., 1947) (R. 283a). The findings and opinions of the Commission dated December 4, 1946, and January 8, 1947, have not yet been officially reported. They are set forth in the Commission's Holding Company Act Release Nos. 7041 (R. 25a) and 7119 (R. 128a).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (28 U. S. C. 347), made applicable by Section 25 of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 835 (15 U. S. C. 79y). The judgment of the Court of Appeals for the Third Circuit was entered on March 19, 1948. Petitions and cross-petitions for rehearing were denied on June 11, 1948. The petition of Central-Illinois Securities Corporation, et al. for a writ of certiorari was filed September 8, 1948, and granted on October 25, 1948.

STATUTES INVOLVED.

Sections 11 (d), (e) and (f), Section 18 (f), Section 24 (a) of the Public Utility Holding Company Act of 1935 (15 U. S. C. 79k (d), (e) and (f); 79r (f); 79x) and Section 77 (e) of the Bankruptcy Act (11 U. S. C. 205 (e)) are set forth in the Appendix at pages 45 to 54, inclusive, in the main brief of The Home Insurance Company, et al., in No. 243.

ANALYSIS OF ISSUES AND SUPPLEMENTARY STATEMENT.

The limited purpose of this sub-division is to clarify the issues, which we think have become confused by certain fundamental inaccuracies and omissions in the statement and argument in the brief of Central-Illinois Securi-

ties Corporation et al. The importance of the deficiencies and their correction may be more readily comprehended if they are considered in relation to the respective contentions of the opposing sides, particularly the contention of each side that it is entitled to succeed as a matter of law without remand to the Commission.

Summary Analysis of Central-Illinois' Contentions.

The Central-Illinois group of common stockholders contends that the preferred stockholders are not entitled to any amount in excess of \$100 per share plus accrued dividends as a matter of law on six bases, namely: (1) the *Otis* case (323 U. S. 624) is distinguishable and the involuntary liquidation preference in the charter is controlling (pp. 33-50, 106-113); (2) if the involuntary liquidation preference is not controlling, nevertheless, the enterprise has been frustrated by Section 11 (b) of the Holding Company Act and the preferred stockholders should, on a theory of rescission, be limited to the amounts which they or their predecessors contributed to the enterprise, theoretically (sic) mirrored by the face amount of the security (which in this case must mean the applicable stated capital, since the shares have no par value) (pp. 51-67, 114-123, part, 57); (3) the Commission's valuations represent only transient market values and the preferred stocks cannot properly be valued at any amount in excess of \$100 per share on the basis of any collection of relevant financial factors or evaluation of the correlative rights of the two classes of stockholders (pp. 72-106); (4) the District Court is not bound to give effect to the findings and conclusions of the Commission (pp. 124-148), and in any event the Commission abused its discretion (p. 125); (5) the District Court decided only that the Commission could not lawfully award more than \$100 per share as the outer limits of permissible action by the Commission on the record, and the Court of Appeals erred in holding that the District Court valued the preferred stocks or substituted any valuation of its own

for that of the Commission (pp. 154-156); and (6) the escrow agreement and related orders of the Commission constitute advance approval by the Commission of the plan as modified by the District Court and remand is therefore inappropriate (pp. 148-153).

The common stockholders seek corroboration for these end results in the findings and conclusions of one or more of the three tribunals, and in the marshalling of such evidence, within or without the record,¹ as furnishes or seems to furnish support for the argument. Apart from such basic questions of law as the effect of the involuntary liquidation preference, or the existence and application of the frustration doctrine, the common stockholders have the considerable task of showing that there is no factual basis to support a valuation of more than \$100 per share and that no other conclusion is permissible. Only in this way can the related factual questions be converted into questions of law and the impact of the substantial evidence rule avoided. Recognizing this necessity, the common stockholders, make the following assertion (p. 125):

"To reach its determination that the plan as approved by the Commission was not fair and equitable, the District Court was not required to disturb, and did not disturb, any factual finding of the Commission. Virtually all the facts upon which the District Court rested its conclusion had been found by the Commission. No attack was made in the courts below, and so far as we are aware none is made here, by any party, upon the accuracy of the facts recited in the District Court's opinion or in its findings. The District Court differed with the Commission's ultimate conclusion, based upon admitted and undisputed facts as set forth in the Court's opinion and findings. And, where the conclusion of the Commission upon the facts is, as here,

¹ See, e. g. footnotes, pp. 12, 41, 43, 69, 76, 77, 78, 86, 90, 95, 96, 97, 101, 102, 118, 119.

either without rational basis or contrary to law, even a 'review' court exercising the most limited review functions would have the power to set aside the conclusion."

Thus the common stockholders set for themselves the task of disqualifying the valuations of the Commission in their factual as well as legal aspects. As part of this undertaking they attempt to show that these valuations are merely transient or speculative market values as of January, 1946; that "the Commission merely accepted Badger's estimate of the hypothetical market prices at which the preferred stocks would have sold at the time of his testimony, assuming liquidation were not to take place," and that Badger's opinion "was not based on the intrinsic merit of the preferred stocks as an investment, but admittedly upon the unprecedentedly low money rates then prevailing" (p. 14).² They couple this with argument that the market values could not possibly exceed \$100 per share and imply that the Courts so found, presumably on the basis of undisputed facts and as a matter of law. Having thus excised the valuations of the Commission, they say the District Court necessarily examined all the factors *in the record* (italics supplied) which could be deemed relevant under any standards recognized in the statute and judicial decisions. They say that these factors could lead to no other conclusion than that reached by the District Court and there is no valid basis for remand, since the Commission has already approved the result under the escrow agreement.

In contrast, the Commission and preferred stockholders contend that they are entitled to the amounts approved by the Commission as a matter of law on three³ main bases,

² The same idea is restated in numerous ways throughout the brief (e. g. pp. 74-79).

³ The Streeter group is also contending that the retirement of the preferred and the liquidation are voluntary (Streeter Brief, pp. 99 et seq.).

namely: (1) the involuntary liquidation preference in the charter is not controlling and the preferred stockholders are entitled to receive the value of the preferred stocks on a going concern basis with full priority as the equitable equivalent of the rights surrendered; (2) the Commission's valuations of the preferred stocks are based on the consideration and weighing of all relevant factors, and conversely, the decision of the District Court is based on irrelevant factors; and (3) since the findings of the Commission are supported by substantial evidence and have rational foundation in law; they are binding on the District Court. Remand to the Commission would be necessary only if, as a matter of law, the Commission failed to consider relevant factors, or considered irrelevant factors, or abused its discretion.

We have, therefore, at the factual base a sharp cleavage in approach and evaluation of facts, with the common stockholders striving to show that the Commission abused its discretion in the area of fact finding and also lost sight of the law. Certain major inaccuracies and omissions in statements of fact and characterization bear importantly on the definition of the real issues and their ultimate resolution. Their correction will serve to define more clearly the issues as presented by the opposing sides, to eliminate certain issues or sub-issues posed by the common stockholders, and aid in bringing out the real facts relevant to the real issues.

Supplementary Statement.

The corrections are grouped according to the related issues.

- (1) *Statements regarding the charter involuntary liquidation preference and the frustration doctrine.*

Preliminarily we note here the concurrence of the common stockholders in our analysis of the process actually

used by the District Court in reaching its decision. In our main brief we stated that, while the District Court seems to agree that the involuntary liquidation preference is not controlling, the Court, nevertheless, treated it as a ceiling for the compensation to the preferred stockholders or at least a major premise for rejecting the findings of the Commission (R. 291a, 316a, Conclusion 4) (Home Brief, pp. 8, 22, 23). The Central-Illinois brief states that the District Court summed up its conclusions by formally finding that the enterprise has been frustrated and terminated by governmental action; that there was no valid basis for hypothesizing a "continuing enterprise" or "going concern" (Central-Illinois Brief, p. 19).

(a) The common stockholders assert that, while the Commission held the involuntary liquidation preference to be a factor to be taken into account, the Commission disregarded it entirely and prescribed the payment of the voluntary liquidation premiums (Central-Illinois Brief, pp. 10, 11, 69). They imply that the dissolution of Engineers was of the type contemplated by the charter (pp. 41-44), and that the Commission was unable to make, and did not make, any finding that the liquidation was not an involuntary liquidation within the meaning of the charter (pp. 39, 44, 45).

The Commission did not disregard the charter provision. The Commission took note of Engineers' statement that it would not be dissolving if Section 11 had not been passed and would have continued into the future for many years (R. 61a, n. 42; See also R. 256a, 635a, 636a, 1240a, 1241a). It found that ordinarily a company in the position of Engineers would exercise its call privilege and redeem its preferred stock at call prices (R. 60a). These considerations completely outweighed the involuntary liquidation factor under the Commission's interpretation of the *Otis* case.

The Commission expressly stated that it must consider all provisions of the charter applicable to the preferred

stocks, such as the dividend rate, call price and liquidation preferences, and must analyze the financial condition of the company with particular regard to the assets and earnings coverage of the stock (R. 62a). It stated it could not accept any argument that the preferred claim is matured by the liquidation and that the involuntary liquidation provision of the charter is the conclusive measure of the claim (R. 61a). Engineers had previously contended that the involuntary preference was not controlling, but only one of many factors to be considered. *The Western Public Service Company*, 12 S. E. C. 804, 814 (1943).

(b) The common stockholders state that the Commission held that the company must pay the preferred stockholders the redemption premiums payable under the charter only on voluntary liquidation or redemption (Central-Illinois Brief, p. 10). This characterization only confuses the issues. The Commission used the call prices as stoppers in reaching its valuations (R. 67a, 68a) and never required the payment of premiums as such.

(2) *The Commission's valuations.*

We have pointed out above (supra, p. 5) how the common stockholders seek to excise the Commission's valuations from the record by first asserting that the Commission did not make any valuations of its own, but merely adopted Badger's valuations, and then characterizing Badger's valuations as irrelevant, transient or speculative market values based upon the low money rates then prevailing and not on the intrinsic merit of the preferred stocks as an investment (Central-Illinois Brief, p. 14). They state (pp. 83, 84) that both Courts so found (R. 310a-315a; 17). They also state that the District Court was not required to disturb, and did not disturb, any factual finding of the Commission (p. 125). The purpose is to make it appear that the record supplies no primary facts or permissible inferences on which the Commission's valuations could be

founded, and conversely, that the record compels valuations not in excess of \$100 per share.

Contrariwise, the Commission and preferred stockholders have disputed, and continue to dispute, any characterization of the Badger valuations and Commission valuations as transient or speculative market values not based on intrinsic worth. The characterization of the Commission's valuations as transient or speculative values on the one hand or intrinsic values on the other hand is in itself a fact-finding operation.

Neither the District Court nor the Court of Appeals found that the Commission did not use its own competence in making valuations or that its valuations are not supported by substantial evidence. The Court of Appeals said the District Court treated the Commission's findings and conclusions with respect as was proper (R. 34), which in itself refutes any conclusion that they are not supported by substantial evidence. The District Court, however, went its own way, supplied its own concepts of legal and factual relevance, and its own weight and emphasis to factors deemed relevant by it, on the legal theory that it was not bound by the findings of the Commission even though based on substantial evidence. The Court of Appeals said that the ultimate conclusion of the District Court was at least not clearly erroneous, that is, within some permissible margin of error (R. 39).

Neither the Court of Appeals nor the District Court found that the values of the Commission are in fact transient or speculative values, although the Court of Appeals thought the District Court had found the money rate used by Badger too low (R. 19; Cf. R. 313a, 314a). Neither Court ventured to predict for the foreseeable future an increase in money rates which would invalidate the valuations.

The District Court in its original decision accepted the valuations in the absence of proof of change, and then excised them for entirely different reasons (R. 290a). The attack on the values was first introduced in the findings of

fact and conclusions of law prepared by the common stockholders and adopted by the Court after the opinion was filed (Home Brief, pp. 7-14). For further discussion see *infra* pp. 18-20.

The Court of Appeals said, "We think that it is apparent on a careful examination of the testimony of the two men (Badger and Barnes) that each was testifying to values as of May, 1946, *ex the Act*." (R. 17) The Court does not make any finding that these valuations are not intrinsic values as of the time of valuation, and it could not very well do so on the basis of a careful examination of the testimony. The common stockholders fail to point out that repeatedly Badger stated that he was appraising the intrinsic values of the preferred stocks, and resorted to current market values and yields of comparable stocks and other factors as tests (R. 1014a, 1015a, 1019a, 1033a, 1175a-1177a, 1184a).

In substance the common stockholders are contending that the valuations were stale at the time of the decision of the District Court (Central-Illinois Brief, p. 97). This contention is based on the assembly of financial data outside the record without the benefit of cross-examination of the authors or any opportunity to present countervailing evidence (e. g., R. 314a; Brief, pp. 95-97). Although the District Court accepted the valuations in the absence of any showing of change, the common stockholders are in effect now asking this Court to find as matter of law that the valuations of the Commission were, nevertheless, stale in May, 1947, and are now stale and must be revised to conform to the date of a final decree in this proceeding. This decree, they say, must take into account the "*material supervening changes, not foreseen or allowed for in the Commission's findings*" (italics supplied) and, presumably as a matter of law, direct the Commission to value the preferred stocks at not exceeding \$100 per share (p. 98).

We cite these variable contentions and the nature of the evidence proffered in their support because of the as-

sertion that the District Court "was not required to disturb, and did not disturb, any factual finding of the Commission" and that "virtually all the facts upon which the District Court rested its conclusion had been found by the Commission" (Brief, p. 125), although the result depends upon *material supervening changes not foreseen by the Commission and not found to exist by the District Court.*

We think these citations bring back into focus the issues centering on the nature of the valuations of the Commission and the substantial evidence rule. We submit that they completely dispose of the contentions that the Commission's valuations were merely transient market values and not intrinsic values and its findings were irrational and not based on substantial evidence.

(3) *The alleged advance approval by the Commission of the Plan as modified by the District Court.*

The common stockholders state that remand is unnecessary because the Commission had given prior consideration and advance approval to the plan in the form approved and enforced by the District Court's order of May 29, 1947 (Central-Illinois Brief, pp. 16, 157).

This statement is the forerunner of another statement that the Commission correctly recognized that the basic issue was one of legal and statutory interpretation, as to which the last word was not in the Commission but in the Courts (p. 152). The purpose is to by-pass the Court of Appeals conclusion that "the problem is and will remain, until its disposition by the Commission, one of valuation of the securities of Engineers" (R. 40). The contention is based on two incomplete citations from the record at page 150 and 151 in the Central-Illinois Brief designed to make it appear that no further proceedings before the Commission were contemplated in any contingency. The material omissions show just the opposite and are supplied below in italics.

ESCROW AGREEMENT (R. 328a).

"4. Upon delivery to you of an opinion of independent counsel, accompanied by a certified copy of the order or decree involved, to the effect that *an order of the Commission in the above mentioned proceedings now pending before it or in any other proceedings under section 11 (b), section 11 (d) or section 11 (e) of the Public Utility Holding Company Act of 1935* or an order or decree of any court having jurisdiction, has been entered, has become final and is no longer subject to appeal, which *Commission order or court order or decree* determines or finds that the holders of Preferred Stock are not entitled to receive any amounts in addition to the amount of \$100 per share plus accrued dividends to be allowed to Preferred Stockholders."

This paragraph 4 complements corresponding provisions in paragraphs 2 and 3 of the escrow agreement relating to additional amounts found payable to the preferred stockholders (R. 325a-327a).

COMMISSION'S PETITION FOR REHEARING (R. 44).

"If the ruling is that the Commission is bound by the District Judge's determination as to amount, then we believe that no remand to the Commission would be necessary, because the Commission has already contingently approved an alternative allocation of cash to preferred stockholders at the amount of the liquidation preference if as a result of the processes of review in the District Court and on appeal therefrom this should be judicially determined fair and equitable." (Footnote 1)

The Court of Appeals has rejected this contention of the common stockholders, pointing out that the escrow agent may make payment only when the order of the District Court has become final and not subject to appeal (R. 139).

We believe this corrected statement of the facts effectively disposes of the issue without further argument.

In this connection the common stockholders state that the District Court did not make any valuation of the equitable equivalent of the rights surrendered by preferred stockholders or substitute any valuation of its own or that of the Commission. The District Court, they say, decided only that the Commission could not lawfully award to the preferred stockholders more than \$100 as the outer limits of permissible Commission action on the record (Central-Illinois Brief, pp. 155, 156).

If the common stockholders mean by their ambiguous statement that the District Court reached its conclusion on the basis of the controlling effect of involuntary liquidation preference in the charter or the frustration doctrine applied with equivalent effect, then their assertions would be correct. But the Court of Appeals said that the problem continues to be one of valuation of the preferred and common stocks, and in this context, any statement that the District Court did not substitute its own valuation for that of the Commission is incorrect. The District Court could not on this theory approve and enforce the payment to the preferred stockholders of \$100 per share without making a valuation, whatever its theory.

They also assert that the Court of Appeals "squarely affirmed the determination of the District Court that the provision of the plan for the payment of the premiums was unfair and inequitable" (pp. 21, 154-156).

Further the Court of Appeals never made any finding which prohibits valuations in excess of \$100 per share.

ARGUMENT.

Much of the argument in the Central-Illinois brief has been anticipated and answered in the main briefs of the Commission and the preferred stockholders and will not be repeated here. Certain points are further answered in our Analysis of Issues and Supplementary Statement (*supra*, pp. 2-13). The purpose of this argument is to answer certain points raised by the common stockholders and in this respect, this argument supplements the anticipatory arguments.

I.

The Contention That the Charter Involuntary Liquidation Preference and the Frustration Doctrine Preclude Payment of More than \$100 Per Share.

We believe that the briefs of the Commission and Streeter Group effectively dispose of the contention that the involuntary liquidation prices for the preferred stocks prescribed by the charter are controlling as a matter of law or equity, and of the attempts by the common stockholders to take Engineer's plan out of the orbit of the *Otis* case. We shall comment here principally on the frustration doctrine.

Central-Illinois cites two cases for the proposition that in reorganizations the equitable equivalent for senior securities "can never exceed the cash amount of the claim", and states that it is not aware of any decision suggesting that the involuntary liquidation claim may be exceeded (p. 36). These cases support neither the proposition nor the statement in reference to this situation.

One case is *Bailey v. Minsch*, 168 F. 2d 635. (C. A. 1, 1948), cert. den. 69 Sup. Ct. 83 (1948). During an equity receivership and while an order to liquidate an investment trust was outstanding, certain debentures were retired at the insistence of the debenture holders in cash.

The Court denied the payment of call premiums and ordered payment at the face amount plus accrued interest. Subsequently the order was revised to permit the continuance of the enterprise on a reduced basis and the motion for payment of premiums was revived. The District Court granted the motion (76 F. Supp. 614) and the Court of Appeals reversed on appeal. The grounds for the limitation were that there was no finding by the District Court of the value of the old debentures or that it was necessary to award the premium to give the equitable equivalent of the old debentures (p. 637); the debenture holders were not being deprived of a favorable investment (p. 638). The Court referred to cases under the Holding Company Act where the possibility of payment of more than the face amount of securities in some situations was recognized, but reiterated that there had been no qualifying finding in this case. Nowhere did the Court say payment in cash could never exceed the face amount of the security.

The other case is *Knight v. Wertheim & Co.*, 158 F. 2d 838 (C. A. 2, 1946), cert. den. sub. nom. *McGuire v. Equitable Office Bldg. Corp.*, 331 U. S. 818. This was a reorganization under Chapter X of the Bankruptcy Act. The original plan provided for payment of debentures partly in convertible bonds and partly in stock. The old debentures appreciated in value above their face amount in anticipation of the consummation of the plan, and the debtor then proposed to amend the plan to pay off the debentures at their face amount in cash. The debenture holders wanted to hold on to the advantages accruing under the first plan and objected. The amendment was allowed. Cases under the Bankruptcy Act are, of course, not in point, since the claims mature.

Bailey v. Minsch (*supra*, p. 14) is a prelude to the "equitable doctrine of frustration" which Central-Illinois advances as an alternative to the involuntary preference (Brief, pp. 51-67; 114-123). It derives from impossibility of performance of contracts by reason of governmental

edict and is characterized by Central-Illinois as a species of rescission by operation of law (p. 57). Central-Illinois then argues that the preferred stockholders are entitled only to the amount contributed by them or their predecessors to the enterprise (pp. 53, 57, 62), which is said to be "theoretically" mirrored by the face amount of the security. The same test is not applied to the common stock, probably for the simple reason that the common stockholders claim all the excess.

This one-sided approach leads to a considerable distortion. Both classes of stockholders are being deprived of the opportunity of sharing in a profitable enterprise. Each class is being deprived of the opportunity of enjoying a pool of capital and its earning capacity. The common stockholders enjoy a leverage through the use of senior capital with limited dividends. The preferred stockholders enjoy a greater security at the cost of a reduced participation in earnings. Each hired the capital of the other for the purpose of exploiting the opportunity. Each is now being deprived of the use of the capital of the other. The common stockholders want to take in addition to the capital amounts contributed by them, all the excess value in the enterprise, that is, the surplus and unrealized appreciation⁴ which reflects the strength of the enterprise built by the combined capital. The future stake which the preferred stockholders have in that excess and the earning power is involved in the frustration just as much as is the continuing opportunity of the common stockholders to enjoy the leverage afforded by the preferred capital at the applicable rates or cheaper rates obtainable on refunding.

Incidentally, the common stockholders state (Brief, p. 118) that had Engineers continued, they would have been free to retain the preferred capital (\$39,000,000) without limitation of time at an over-all cost of approximately

⁴This unrealized appreciation is substantial. See, for example, valuations of subsidiary stocks by Barnes, (R. 981a-983a; also p. 497a).

5.40%, while realizing some 12½% on this capital (pp. 117-118). The 12½% rate is based on alleged current market values for common stock, and of course, the company would not earn 12½% on the preferred capital; the average rate for the entire capital would be lower.

Since the common stockholders claim all the excess without regard for the amount of capital contributed by them or their predecessors, they must do so on the theory that contractually the common stock is entitled to such excess. They do not, however, accept this theory with respect to alleged losses realized on divestments or lost opportunities arising from divestments, which are cited as reasons for limiting the preferred stockholders to their "theoretical" contribution.

The considerations which lead the Court to adopt the principle of equitable equivalents in the *Otis* case are equally valid under any doctrine of frustration. We are not here dealing with an executory contract but with the product of approximately 20 years of operations. The original contributions of the limited partners and general partners are not true measures of their relative positions in the enterprise at the time of its dissolution in June, 1947. Talk about disappointed expectations on one side or the other accomplishes nothing. The disappointments are mutual. As the Court of Appeals said the problem continues to be one of valuation of the respective claims:

In this case the common stockholders have elected to take the stocks in the operating companies and the other residual assets and pay off the preferred stockholders in cash. They selected the form of the remedy. They seek to take the whole excess over the involuntary liquidation preference of the preferred stocks by maturing their claims as common stockholders, and thereby deprive the preferred stockholders of a position found to have value at least equal to the voluntary redemption prices as the equitable equivalent of the rights surrendered. The windfall would go to the common stockholders.

II.

The Contention That the Preferred Stocks Could Not Be Valued at More Than \$100 Per Share.

We have already described the nature, purpose, and to some extent the quality of this effort (Central Illinois Brief, pp. 72-106) in the Analysis of Issues and Supplementary Statement (*supra*, pp. 3-5, 8-11). By an admixture of data selected from record and non-record sources, assumptions, characterizations, and computations on variable bases, we are told that a present price for the preferreds would probably be less than \$90 per share on a comparable yield basis (Brief, pp. 95-96, n. 2) and approximately \$70 per share on the basis of normal earnings capitalized (p. 101, incl. n. 2). The purpose, of course, is to make it appear that payment of \$100 per share was liberal treatment (p. 96). The subjective nature of the processes and the weaknesses of the techniques and results are readily apparent on reading. We will not, therefore, undertake a detailed exposure and will continue to rely on the special competence of the Commission as reflected in its findings and the acceptance of the Badger values by the District Court (R. 290a).

We will, however, comment on the use made by the common stockholders of Findings Nos. 41 to 54, inclusive, of the District Court (R. 310a-315a). Included in these findings are certain findings (Nos. 49-54, inclusive) of prospective import. They include an enumeration of factors which might in the future adversely affect the valuations of the preferred stocks. They include statistics relating to declines in market prices of securities in the terms of averages and a concomitant trend toward somewhat higher money rates (R. 314a). These findings are cited as proof that the District Court based its decision on such factors (Central-Illinois Brief, pp. 85, 97).

In our main brief we pointed out the difference in the approach and findings of the District Court in its opinion

as compared with the subsequent findings (Home Brief, p. 7). In the opinion the District Court accepted the Badger valuations, but scaled them down to \$100 per share because of other off-setting factors not in any way related to market conditions or money rates (R. 290a). The Court did not in its opinion charge that the Commission valuations or the Badger valuations were transient market values or challenge the stability of the prevailing money rates. Actually the Court used the low money rates to challenge the fairness of the preferred dividend rates as excessive and to scale down the preferred contract for the purpose of evaluating the equities on its own scales (R. 291a) (Home Brief, pp. 23, 24). In this way the low money rates were integrated in the Court's findings.

In Finding No. 52 the District Court said (R. 314a):

"Continuance for two or three years of the trend indicated over the past year could substantially reduce or wholly eliminate the differential in the current yield rate over dividend rate in the case of preferred stocks of the type of Engineers."

The common stockholders ask that this observation be accepted as a prophecy come true (Central-Illinois Brief, pp. 97-98). We submit that it cannot now be demonstrated that there has been any substantial departure of a permanent nature from the money rate levels prevailing at the time the valuations were made, or that any increases which may have occurred substantially reduce or wholly eliminate the differential between the dividend rates for the preferred stocks of Engineers and the yield rate of 4.6% adopted therefor by Badger. Certainly such speculations should not now be substituted for valuations based on substantial evidence and applicable when the preferred stocks were surrendered in June, 1947.

Findings such as No. 52 are susceptible to subtle applications on appeal. They can be brought into play whenever the indicated trend seems to have set in. Whether

or not the indicated trend has set in and is something more than a fluctuation of temporary nature is usually determined by hindsight. We submit that the supplemental findings of the District Court should be evaluated with relation to the original decision of the District Court, which on its face was based on a wholly different theory. The following observation in *Matton Oil Transfer Corp. v. The Dynamic, et al.*, 123 F. 2d 999, 1001 (C. A. 2, 1941) is appropriate:

"We agree fully with the spirit and the terms of the resolution passed by a majority vote of the judges at our Judicial Conference of last June recommending 'that the trial judge make brief, pertinent findings in respect to contested matters and file the same in connection with his opinion.' This puts the emphasis where it should be, namely, on brief and pertinent findings of contested matters, and also upon a finding made as a part of the judge's opinion and decision, rather than the delayed, argumentative, over-detailed documents prepared by winning counsel after the event which often appear in appellate records, though they are not effective aids to adjudication."

See also *United States v. Forness*, 125 F. 2d 928, 942 (C. A. 2, 1942).

III.

The Contention That the District Court May Exercise Its Independent Discretion and Is Not Bound by Findings of the Commission Based on Substantial Evidence and Having Rational Foundation in Law.

The common stockholders have said that "the disagreement of the District Court with the Commission as to the payment of premiums was basically a disagreement as to applicable legal principles" (Central-Illinois Brief, p. 16). As pointed out above (pp. 4-5, 8-11) they include in this characterization of the issues, the postulate that as mat-

ters of law there is no evidence or no substantial evidence to support a valuation of more than \$100 per share for the preferred stocks, and the contention that even if there is substantial supporting evidence for the valuations of the Commission, the substantial evidence rule does not apply to the District Court in Section 11 (e) proceedings. It is not clear whether they would consider findings of fact by the District Court based on substantial evidence binding on the Commission, but looking in that direction is the statement of the Court of Appeals that the District Court's decision should stand if not clearly erroneous. (R. 39).

The Commission and preferred stockholders contend that, as matters of law, the substantial evidence rule does apply and that there is substantial evidence to support the valuations of the Commission. We are, therefore, in agreement that the difference between the District Court and the Commission was basically a disagreement as to applicable legal principles, but for different reasons. If the Commission failed to consider and weigh any factors legally relevant, then, of course, further fact-finding operations by the Commission will be necessary.

The existence of substantial evidence to support the findings of the Commission has been demonstrated in the main briefs of the Commission and the preferred stockholders. In our supplementary statement we have exposed and corrected the postulates of the common stockholders in this respect (*supra*, pp. 4-5, 8-11). Likewise, the respective roles of the Commission and District Court and the standing of administrative findings in Section 11 (e) have been thoroughly covered and the arguments of the common stockholders anticipated and answered.

We have said that the resolution of this question is largely a matter of attitudes (Home Brief, p. 39). Congress has set up a statutory plan for carrying out the integration and simplification of holding company systems, and it may fairly be assumed that it intended to have a workable plan. If the district courts are to exercise inde-

pendent, full, self-contained, plenary judgment, if they are to exercise independent discretion and be sustained so long as their conclusions are not clearly erroneous, we do not have a workable plan. Sincere and objective fact-finding is exposed and subordinated to the need for workability and for results which then can only be obtained by compromises.

We return to the suggestion that the stature of the findings of the Commission is as great in the District Court as in the Court of Appeals where such findings are conclusive if based on substantial evidence.

Respectfully submitted,

FRANCIS H. SCHETZ,
*Attorney for The Home Insurance Company, et al.,
Petitioners-Respondents.*

January 5, 1949.